IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

FIRST NATIONAL BANK OF PALMERTON	:	
Plaintiff	:	CIVIL ACTION
	:	
v.	:	
	:	NO. 98-3049
DONALDSON, LUFKIN & JENRETTE	:	
SECURITIES CORPORATION	:	
Defendant	:	

MEMORANDUM AND ORDER

YOHN, J. March , 1999

Plaintiff First National Bank of Palmerton ("the bank") has brought suit against Donaldson, Lufkin & Jenrette Securities Corporation ("DLJ"), claiming negligence, breach of fiduciary duty, and fraud. The suit arises out of a security interest taken by the bank in marketable securities held for the debtor in a DLJ brokerage account. Pending before the court is defendant's motion to dismiss. The court finds that the bank has failed to plead the necessary elements to state a cause of action for negligence, breach of fiduciary duty, or fraud. Therefore, plaintiff's complaint will be dismissed.

I. BACKGROUND

On May 15, 1996, the bank entered into a loan agreement with Pankesh Kadam and Alka Patel ("first loan"). See Complaint ¶ 5. As part of this agreement, Kadam and Patel signed a

promissory note in the amount of $50,000. See id. The parties to the loan agreement also signed a security agreement in which the borrowers granted the bank a security interest in, among other things, marketable securities registered in Patel's name and held by DLJ in Account Number 219-141298. See id. ¶ 6. The securities were valued at $56,350. See id., Attachment B.

On the same day that Patel and Kadam entered into the loan agreement, the bank sent a letter to DLJ explaining that Patel had "pledged the marketable securities" and "she agreed to have the bank perfect its interest in the stocks." Id. Attachment C. In the letter, the bank requested that DLJ either "forward the stock certificates or an agreement from [DLJ] that the securities will remain in the account until notification from the bank." Id. At the end of the letter, Patel had signed an acceptance and acknowledgment whereby she "consented to the stock certificates being forwarded to The First National Bank of Palmerton." Id. DLJ forwarded the stock certificates to the bank. See id. ¶ 8.

Some time after the Bank received the certificates from DLJ, Patel allegedly requested that the stocks be returned to her brokerage account to enable her to trade them. See id. ¶ 9. The bank agreed and on August 20, 1996, sent the stock certificates back to DLJ. See id. Accompanying the stocks was a transmittal letter in which the bank's vice-president stated, "The stocks are being returned to you to be retained in Ms. Patel's account. It is our understanding that she will trade the stocks, however, maintain the principal balance in her account #219-141298." Id., Attachment D. The complaint contains no allegation that DLJ ever responded to this letter.

On June 6, 1997, Patel individually executed a second promissory note for $25,000 ("second loan"). See id. ¶ 10. Collateral for the loan consisted of the DLJ brokerage account

Number 219-141298 then valued at $60,520.52. See id. ¶ 11. Patel signed a security agreement and a collateral pledge agreement which granted the bank an assignment and security interest in the account. See id. ¶¶ 11-12. On May 22, 1997, prior to the execution of the promissory note and security agreement, the bank sent DLJ a copy of the collateral pledge agreement. See id. ¶ 13. The bank also requested that DLJ sign and return an acknowledgment form whereby it would agree that the bank, as the secured party, would have the sole right to make withdrawals from the collateral. See id., attachment H. The acknowledgment form was signed by the bank's vice-president and Patel. See id. DLJ, however, did not sign the form or return it to the bank. See id. ¶ 14.

Seven months later, on December 15, 1997, Kadam and Patel defaulted on the first loan. See id. ¶ 15. At the same time, Patel defaulted on her payments under the second loan. See id. ¶ 16. When the bank tried to liquidate the securities in the collateral brokerage account in order to apply the funds toward the borrowers' outstanding debt, it learned that Patel had liquidated the account the previous month. See id. ¶ 17. Plaintiff alleges that Patel liquidated the account without obtaining express written consent from the bank. See id. In an effort to recover its loss, the bank has brought suit against DLJ claiming that by allowing Patel to liquidate the brokerage account, DLJ was negligent, breached its fiduciary duty, and committed fraud.

II. LEGAL STANDARD

DLJ has filed a motion to dismiss for failure to state a claim upon which relief can be granted. Fed. R. Civ. P. 12 (b)(6). The purpose of a Rule 12(b)(6) motion is to test the legal sufficiency of the complaint. Sturm v. Clark, 835 F.2d 1009, 1011 (3d Cir. 1987). In deciding a

motion to dismiss, the court must "accept as true all allegations in the complaint and all reasonable inferences that can be drawn from them after construing them in the light most favorable to the [non-moving party]." Jordan v. Fox, Rothschild, O'Brien & Frankel, 20 F.3d 1250, 1261 (3d Cir. 1994) (citing Rocks v. Philadelphia, 868 F.2d 644, 645 (3d Cir. 1989)). At this stage of the litigation then, "[a] court may dismiss a complaint only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." Hishon v. King & Spalding, 467 U.S. 69, 73 (1984).

III. DISCUSSION

DLJ argues that the bank has failed to plead facts sufficient to state a cause of action for negligence, breach of fiduciary duty, or fraud. With regard to the negligence and breach of contract claims, DLJ asserts that it had no duty to act on behalf of the bank. See Memorandum of Law in Support of Motion of Defendant Donaldson, Lufkin & Jenrette Pursuant to 12 (b)(6) to Dismiss the Complaint of First National Bank of Palmerton ("Def.'s Mem. of Law") at 8. As such a duty is a required element of the claims of negligence and breach of fiduciary duty, DLJ contends that plaintiff's complaint is deficient with regard to these causes of action. See id. Additionally, DLJ argues that the bank has failed to allege the necessary elements to state a claim for fraud. See id.

A. Negligence and Breach of Fiduciary Duty Claims

To state a cause of action for either breach of fiduciary duty or negligence, the bank must allege the existence of a duty owed to it by DLJ. See Baer v. Commonwealth Dept. of Trans.,

713 A.2d 189, 191 (Pa. Commw. Ct. 1998) (stating that negligence cause of action requires "a duty, recognized by law, requiring the actor to conform to a certain standard with respect to the injured party"); Restatement (Second) of Torts § 874 (1979) ("fiduciary relation exists between two persons when one of them is under a duty to act for . . . the benefit of another upon matters within the scope of the relation"). DLJ claims that the bank did not perfect its security interest in the securities held in the DLJ account in accordance with the Pennsylvania Uniform Commercial Code. See Def.'s Mem. of Law, at 2. Because the bank failed to perfect its security interest, defendant asserts that it "had no duty under the UCC to act for the benefit of the Bank." See id. at 8. Absent this duty, DLJ contends, the allegations in the complaint do not support the bank's claims of negligence and breach of fiduciary duty. Id.

Sections eight and nine of the Uniform Commercial Code ("UCC"), as codified in the Pennsylvania statutes, set forth the rights and duties of parties participating in secured transactions involving marketable securities such as those maintained in Patel's account with DLJ.[1] For purposes of the UCC, the collateral at issue here falls into the category of investment property, which includes certificated and uncertificated securities, security entitlements, and

[1] The bank discusses at length the fact that the two security interests at issue here came into effect under different versions of the UCC. The bank and Patel executed the first security agreement on May 15, 1996. Six months later, on November 22, 1996, a new version of those sections pertaining to investment securities, took effect in Pennsylvania. The bank and Patel negotiated the second security agreement on June 6, 1997 -- after the effective date of the amended UCC. When it enacted the 1996 version of the UCC, the Pennsylvania legislature required secured parties who had perfected security interests under old perfection rules not contained in the new version, to perfect their interests in compliance with the new rules by March 22, 1997. Title 13, section 8101, Historical and Statutory Notes. Thus, if the bank had a perfected security interest in Patel's securities prior to November 22, 1996, through notification as it claims, in order to maintain perfection, the bank had to either file or obtain control as provided by title 13, section 9115 (d), by March 22, 1997. As the opinion later reveals, the bank failed to do either.

security accounts. See 13 Pa. Cons. Stat. Ann. § 9115 (a) (West Supp. 1998) (defining investment property). The term "security entitlement" is defined as "the rights and property interest of a person who holds securities or other financial assets through a securities intermediary." Title 13, section 8102 (a), UCC Comment ¶ 17. The UCC defines a "securities intermediary" as "a bank or broker . . . that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity." Title 13, section 8102 (a). Both parties agree that DLJ qualifies as a securities intermediary who maintained Patel's securities in her brokerage account. See Def.'s Mem. of Law at 7; Pl.'s Mem. of Law at 6. Patel's interest in these securities in her account constituted a security entitlement and Patel was the entitlement holder or the "person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary. Title 13, section 8102(a).

In the instant case, Patel granted to the bank a security interest in her security entitlements. In and of itself, this transaction did not establish a duty between DLJ, the securities intermediary, and the bank, the secured party. Although Pennsylvania courts do not appear to have considered this issue yet, the drafters of the Uniform Commercial Code have stated that a "securities intermediary owes no duties to the secured party, unless the intermediary has entered into a 'control' agreement in which it agrees to act on entitlement orders originated by the secured party."[2] Uniform Commercial Code § 8-507, 2C U.L.A. 147 (Supp. 1998) (citing to

[2] Both parties discuss the issue at bar regarding the existence of a duty as hinging on whether the bank perfected its security interest. Review of the UCC (both Pennsylvania's codified version and that contained in the Uniform Laws Annotated) reveals that entering into a control agreement with the securities intermediary appears to be the only means of establishing a duty between a securities intermediary and a secured party. A control agreement, however, is not the only means of perfecting a security interest in investment property such as that maintained in Patel's account. See Title 13, sections 8106, 9115. A secured party may perfect a security

UCC § 8-106). A "control agreement" is created when "the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder."[3] Id. § 8106 (d) (emphasis added). Thus, the legal duty owed by DLJ to the bank that is necessary to support claims of negligence and breach of fiduciary duty, could arise only if the bank, Patel, and DLJ all agreed that the bank had the power "to have the securities sold or transferred without further action by [Patel]." Title 13, section 8106 (d) (2), UCC Comment 7.

To obtain control through an agreement in conformance with section 8106 (d)(2), a secured party cannot simply notify the intermediary of the secured party's interest and the debtor's willingness to allow entitlement orders to issue from the secured party -- "it is essential

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interest in investment property by "control" or by filing. See id. § 9115 (d). The bank did not file a financing statement either time that it sought to take an interest in the securities. See Plaintiff's Mem. of Law in Opp. to Def.'s Mot. to Dismiss ("Pl.'s Mem. of Law") at 13. Thus, for perfection to have occurred, the bank must have taken control of the security account.

Control of a security entitlement can be achieved in one of two ways: through a control agreement or by having the secured party become the entitlement holder. See Title 13, section 8106 (d). To acquire a securities entitlement and thus become the entitlement holder, the bank would have needed to establish a separate securities account to which DLJ would credit Patel's securities. See id. § 8501 (b). Plaintiff does not allege that this occurred and, thus, it cannot claim to be the entitlement holder. This leaves a control agreement as the sole means by which the bank could have perfected its security interest.

Consequently, in this particular case, whether the bank perfected its security interest and whether DLJ owes any duty to the bank both depend on whether the bank controlled the securities and account by means of a control agreement.

[3] The UCC defines an entitlement order as a "notification communicated to a securities intermediary directing transfer or redemption of a financial asset to which the entitlement holder has a security entitlement." Title 13, section 8102(a). The official comment to the UCC § 8-507, notes that "[t]he term entitlement order does not refer to instructions to a broker to make trades . . . . Rather, the entitlement order is the mechanism of transfer for securities held through intermediaries." Uniform Commercial Code § 8-507, 2C U.L.A. 147 (Supp. 1998).

that the . . . securities intermediary . . . actually be a party to the agreement." Title 13, section 8106 (d)(2), UCC Comment 5; see William D. Hawkland et al., Uniform Commercial Code Series § 8-106:04 (Main Volume 1996) (stating that sending notice of security interest to intermediary is insufficient to establish control through agreement). While the intermediary must "specifically agree" to allow the secured party to issue entitlement orders, the statute does not require that the intermediary agree in writing. See Title 13, section 8106 (d)(2), UCC Comment 5; Hawkland, supra (noting that asserting existence of unwritten agreement likely would occur as "a rescue effort in litigation for a transaction in which someone made some fairly obvious blunders in practical planning"). The bank acknowledges that no written control agreement exists in this case. Instead, the bank claims that DLJ's conduct in response to three separate letters from the bank evidences its assent to follow entitlement orders from the bank without concurrence from Patel.

> The first of these letters sent to DLJ on May 15, 1996, stated in relevant part:
>
> > As per our prior discussions, Alka P. Patel has pledged the marketable securities in Account #219-141298 to the First National Bank of Palmerton for a loan. As a result, she agreed to have the bank perfect its interest in the stocks. Please forward the stock certificates or an agreement from your firm that the securities will remain in the account until notification from the bank.

Complaint, Attachment C. Below the closing and signature of the bank's vice-president, the letter included the following paragraph:

> > ACCEPTANCE: I acknowledge that I have pledged the securities in my stock Account #219-141298 and hereby consent to the stock certificates being forwarded to the First National Bank of Palmerton.

Id. (emphasis added). Patel's signature appeared beneath this paragraph. See id. In response to this letter, DLJ sent the stock certificates to the bank. See Complaint ¶ 8.

The bank claims that "it clearly thought that [DLJ's forwarding of the stock certificates to the bank] implied DLJ's agreement to the terms of the security arrangement generally."[4] Pl.'s Mem. of Law at 18. The complaint, however, contains no allegation that DLJ was in possession of or had knowledge of the security agreement such that it could have agreed with all or any of its terms. Furthermore, DLJ's conduct evidences only that it complied with Patel's explicit authorization which extended exclusively to delivering the stock certificates to the bank. See Complaint, Attachment C. Thus, despite what the bank says it "thought", the complaint contains no evidence of a control agreement having been entered into at this point.

On August 20, 1996, the bank sent the certificates back to DLJ accompanied by a transmittal letter in which the bank stated:

> Enclosed please find the following stock certificates in the name of Alka Patel:
> 2000 shares Hospitality Properties Trust
> 1175 shares Q Sound Labs, Inc.
> The stocks are being returned to you to be retained in Ms. Patel's account. It is our understanding that she will trade the stocks, however, maintain the principal balance in her account #219-141298.

Complaint, Attachment D (emphasis added). DLJ credited Patel's account with the securities.

In its memorandum in opposition to DLJ's motion to dismiss, the bank states that "when

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[4] Neither party points to specific language in the security and loan agreements that would, if agreed to by DLJ, amount to an agreement meeting the requirements of title 13, section 8106 (d) (2) of the Pennsylvania Code. Paragraph nine of the security agreement does state that "Creditor is hereby appointed Debtor's attorney-in-fact to do all acts and things which Creditor may deem necessary to perfect and continue perfected the security interest created by this Agreement and to protect the goods and chattels." Complaint, Attachment B. Because control is one means of perfecting, this seems to have given the bank the power to enter into a control agreement. Addressing the situation in which a debtor gives power of attorney to the secured party, the comment to section 8106 notes that if the "securities intermediary does not specifically agree to this arrangement, the secured party does not have 'control' within the meaning of subsection . . . (d)(2) because the . . . securities intermediary is not a party to the agreement." Title 13, section 8106, UCC Comment 5.

[it] returned the certificates to DLJ . . ., it relied on its understanding that DLJ would be bound by the terms of the parties' agreement, which was that, in the absence of a possessory pledge, DLJ would undertake to see that the principal balance in the account would remain in its custody." Pl.'s Mem. of Law at 18. Plaintiff's claim appears somewhat disingenuous, however, given that the complaint contains no allegations that any agreement to that effect between DLJ and the bank actually existed at the time the bank sent the certificates to DLJ. Perhaps in the alternative, the bank also contends that DLJ's acceptance of the returned certificates demonstrated its agreement to maintain the balance in the account. See id. at 20.

Neither the UCC nor Pennsylvania contract law require that acceptance of an offer be in writing or even be an express oral acknowledgment -- conduct can suffice. see Hawkland supra (stating that nothing in UCC requires that control agreement be in writing); Occidental Chem. Corp. v. Environmental Liners, Inc., 859 F. Supp. 791, 794 (E.D. Pa. 1994) (stating that offer may be accepted through conduct of offeree); Schreiber v. Olan Mills, 627 A.2d 806, 808 (Pa. Sup. Ct. 1993) (noting that "one may look to the 'conduct' of the parties to ascertain the acceptance of the agreement"). Whatever form the acceptance takes, however, it must be "unconditional and absolute." O'Brien v. Nationwide Mut. Ins. Co., 689 A.2d 254, 258 (Pa. Super. Ct. 1997); see Schreiber, 627 A.2d at 808 (holding that no contract existed where "[t]here was no 'unconditional' manifestation on the part of [the defendant] that a contract was acknowledged by behavior of the defendant"). DLJ's "conduct" in receiving the returned certificates and crediting them to Patel's account does not meet this standard.

The bank analogizes DLJ's actions in this case to the plaintiff's conduct in Occidental. In that case the plaintiff negotiated a check that the defendant had enclosed with a letter which

stated, "this payment retires all outstanding balances with your firm. This payment is tendered as payment in full and represents all outstanding monies . . . ." Occidental Chem. Corp., 859 F. Supp. at 795. The Court held that the plaintiff's negotiation of the check constituted acceptance of the terms under which the check had been tendered to the plaintiff (i.e. that it was payment in full). See id. at 794 (stating that "[a] creditor may not simply disregard the language on a check by crossing out the language or informing the debtor that the language would be ignored.").

The bank argues that its letter similarly communicated a conditional offer -- that retention of the securities was contingent upon DLJ agreeing to maintain the balance in the brokerage account. See Pl.'s Mem. of Law at 20. Presumably, the bank is also arguing that such an agreement would serve as a control agreement binding DLJ to entitlement orders from the bank without concurrence from Patel. Despite the bank's desire to have the letter convey such an understanding, the plain language in no way makes that intent clear. The letter does not state who, Patel or DLJ, the bank believes will maintain the balance in the account, and nowhere does it state that return of the securities to Patel's account is conditioned upon DLJ's agreeing that it will take responsibility for maintaining the balance. More importantly, as defendant notes in its reply, the letter does not assert that the bank had the power and intention to issue entitlement orders regarding Patel's account. See Reply of Donaldson, Lufkin & Jenrette in Supp. of its Mot. to Dismiss Pl.'s Complaint ("Def.'s Reply") at 3. Unlike in Occidental, the bank's letter conveyed no clear explanation of its intentions and expectations of DLJ. In other words, it contained no clear offer. Consequently, DLJ's retention of the securities cannot be interpreted as an "unconditional and absolute" acceptance of anything -- there was no offer to accept. See O'Brien, 627 A.2d at 808 (stating that enforceable agreement requires "'offer', 'acceptance',

'consideration', or 'mutual meeting of the minds'").

Pursuant to its second loan to Patel, on May 22, 1997, the bank sent a copy to DLJ of the collateral pledge agreement, an acknowledgment form, and a letter which stated the following: "Enclosed please find a form acknowledging Alka Patel's assignment of her stock account to our bank. Please sign where indicated by the 'X' and return to me in the enclosed self-addressed envelope." Complaint, Attachment H. According to the terms of the acknowledgment form, DLJ's signature would have demonstrated agreement with the following statement: "We have received your notice of this agreement. We agree that no account holder or any other person (other than you, the secured party) has any right to make any withdrawals from the collateral until this agreement is released in writing by you." Id., Attachment G. Both the letter and the acknowledgment form were signed by the vice-president of the bank and Patel. See id., Attachments G, H. DLJ did not sign the form or acknowledge receipt of it in any way.[5] See id. ¶ 14.

DLJ contends that, as with the first loan and security interest, no agreement existed between DLJ, Patel, and the bank such that the bank had control of the account pursuant to § 8106 (d)(2). Def.'s Mem. of Law at 7. In response, the bank argues that, because a security agreement was already in place with respect to the securities, and the bank had agreed to maintain the principal balance regardless of which securities were held in the account, the bank "perfected" its security interest in the account when it "forwarded to DLJ the collateral pledge agreement signed by the debtor." See Pl.'s Mem. of Law at 18-19. In essence, the bank seems to

[5] It should be noted that a securities intermediary has no statutory obligation to enter into a control agreement, even if the registered owner or entitlement holder requests the intermediary to do so. See Title 13, section 8106 (g).

be arguing that a control agreement existed with respect to the entire contents of the account as a result of DLJ's having accepted the securities back from the bank, and consequently, a control agreement was in place with regard to the account itself.

If a control agreement had already existed between the parties and Patel, plaintiff's argument would have some merit. See Title 13, section 9115 (stating that with regard to control, "a secured party has control over a securities account . . . if the secured party has control over all security entitlements . . . in the securities account"). As discussed above, however, no control agreement was in place at the time the bank negotiated the second loan.

Taken individually, the actions of DLJ do not support a finding that a control agreement existed pursuant to section 8106 (d)(2). Nevertheless, the bank argues that DLJ became "obligated to recognize the security interest because of the pattern of dealings among the parties during the whole course of the transactions." Pl.'s Mem. of Law at 18. DLJ's alleged conduct during this period amounts to the following: (1) not creating and forwarding a written agreement regarding the certificates pursuant to the bank's first letter on May 15, 1996; (2) placing the stock certificates into the brokerage account of Patel, the registered owner and entitlement holder; (3) not signing and returning to the bank an acknowledgment of Patel's assignment of a second interest in her account; (4) following Patel's order to liquidate the account. None of these alleged actions, viewed individually or as a whole, evidence an intent to enter into an agreement with the bank and Patel such that DLJ would accept entitlement orders emanating solely from the bank. As no agreement existed, no duty arose between DLJ and the bank. Because the bank cannot allege the existence of a duty, I must dismiss plaintiff's negligence and breach of fiduciary duty claims.

B. Fraud

In addition to allegations of negligence and breach of duty, plaintiff claims that DLJ committed fraud when it "unlawfully, willfully and maliciously permitted Alka Patel to liquidate DLJ Brokerage Account No. 219-141298, with intent to hinder and delay the bank's enforcement of its security interests in such account." To state a claim for fraud under Pennsylvania law, a plaintiff must plead the following elements: "(1) a representation; (2) which is material to the transaction at hand; (3) made falsely, with knowledge of its falsity or recklessness as to whether it is true or false; (4) with the intent of misleading another into relying on it; (5) justifiable reliance on the misrepresentation; and (6) the resulting injury was proximately caused by the reliance." Huddleston v. Infertility Ctr. of Am., Inc., 100 A.2d 453, 461 (Pa. Super. Ct. 1997). In accordance with the Federal Rules of Civil Procedure, plaintiffs must plead averments of fraud with particularity. See Fed. R. Civ. P. 9(b). DLJ contends that the bank has failed to allege facts sufficient to plead these elements. See Mot. to Dismiss at 9. Specifically, defendant claims the complaint contains no allegations that DLJ made a false representation to the bank. See id. The bank does not address DLJ's argument regarding the fraud claim in its response to the motion to dismiss.

The court agrees with defendant that the bank has failed to allege with particularity any false representation made by DLJ in this matter. Reading the complaint in the light most favorable to plaintiff, the court is unable to discern what representation the bank believes was untruthful. Even without the heightened pleading requirements for claims of fraud, plaintiff's allegations would seem to fall far short of stating a cause of action. Therefore, plaintiff's claim of fraud must be dismissed.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

FIRST NATIONAL BANK OF PALMERTON	:	
Plaintiff	:	CIVIL ACTION
	:	
v.	:	
	:	NO. 98-3049
DONALDSON, LUFKIN & JENRETTE	:	
SECURITIES CORPORATION	:	
Defendant	:	

ORDER

AND NOW, this day of March 1999, upon consideration of defendant's motion to dismiss, plaintiff's response thereto, and defendant's reply, IT IS HEREBY ORDERED that the motion to dismiss is GRANTED and plaintiff's complaint is dismissed with prejudice.

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William H. Yohn, Jr., J.